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Making progress to sustain homeownership

Senate Banking Committee bill would transfer loan credit risk to third parties, not taxpayers

By Rohit Gupta

• June is National Homeownership Month, an important reminder that homeownership remains a cornerstone of the American dream. It is also a reminder that there is unfinished work left to do to put our housing finance system on a more sustainable footing so that more Americans will have access to prudent and affordable mortgage credit well into the future, and taxpayers are shielded from risks.

Fortunately, there is movement on Capitol Hill and by regulators to make progress right now. Legislation recently introduced by Sen. Shelby (R-Ala.) and passed by the Senate Banking Committee includes a provision that would call on the Government Sponsored Enterprises ("GSEs") to engage in "front end" risk sharing transactions, which transfers credit risk to third parties when the loan is originated, rather through "back end" risk sharing on loans that are already on the GSEs' balance sheets. This effort would make greater use of private capital to "de-risk" the GSEs and lower the exposure and costs for the GSEs and taxpayers. While the provision requires some additional refinement, the front end risk sharing approach offers the prospect of lower costs to borrowers, and could help to enhance the availability and affordability of mortgage credit.

One straightforward way to do front end risk sharing is by using private Mortgage Insurance (MI). Today, MI already provides significant risk protection backed by private capital against losses on low down payment loans. The GSEs and the Federal Housing Finance Agency (FHFA) recently finalized Private MI Eligibility Requirements (PMIERs), setting robust operational and financial standards, which provide greater market confidence in the value and role of a strengthened MI industry. The PMIERs establish the foundation for MI to provide greater front end risk sharing solutions that will work today and as part of any future mortgage finance system, and serve as a blueprint for standards that should be applied to all GSE counterparties as part of front end risk sharing.

Front end risk sharing using MI could be done at least two ways. Traditionally, for loans with down payments under 20 percent of the home value, MI – not taxpayers – covers the first losses if there is a default, up to certain coverage limits. In the future, MI could provide even "deeper cover" on these loans. This "deeper MI coverage" would offer the advantages of reducing risks to the taxpayers while allowing the GSEs to lower their fees, thereby maintaining borrower access to affordable mortgage credit. And with lower GSE fees, this approach would lower costs to borrowers.

In addition, MI can be used to provide front end risk sharing on loans with down payments greater than 20 percent. Today these loans do not require MI coverage, but use of front end risk sharing on these below 80 percent LTV loans through MI coverage for first losses would put the GSEs, and taxpayers, at a much more remote risk of losses. This would put more private capital at risk ahead of the taxpayer-backed GSEs, which should directly translate into lower costs to borrowers.

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The opportunity for more Americans to achieve homeownership remains an important goal, but to make that vision a reality, we will need a housing finance system that is more sustainable and less reliant on taxpayers. Promotion of greater front end risk sharing with MI is a way to help build a strong, stable housing finance system, provide prudent access to affordable mortgage credit, protect taxpayers, and help ensure the homeownership aspirations of Americans for years to come.

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